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No. 90-1567

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ARDRA INSURANCE COMPANY LTD., et al.,

Petitioners,

vs.

SALVATORE R. CURIALE, SUPERINTENDENT OF INSURANCE OF THE STATE OF NEW YORK, AS LIQUIDATOR OF NASSAU INSURANCE COMPANY, IN LIQUIDATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE NEW YORK STATE COURT OF APPEALS

RESPONDENT'S BRIEF IN OPPOSITION

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May 10, 1991

COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Whether the statutory Liquidator of an insolvent insurer is bound by the insurer's pre-liquidation arbitral agreement with a Bermuda affiliate?

2. Whether the statutory liquidation of an insolvent insurer, centralizing its affairs in a State Liquidation Court, renders its pre-liquidation arbitral agreements "null and void, inoperative or incapable of being performed" within the meaning of Article II.3 of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards?

3. Whether the McCarran-Ferguson Act bars application of the Convention to compel the statutory Liquidator of an insolvent insurer to arbitrate claims for reinsurance proceeds due from an alien reinsurer?

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent Salvatore R. Curiale, Superintendent of Insurance of the State of New York, as Liquidator of Nassau Insurance Company (the "Liquidator") respectfully submits this Brief in Opposition to the petition for writ of certiorari to the New York Court of Appeals.

COUNTERSTATEMENT OF THE CASE

Nassau Insurance Company ("Nassau") was a stock casualty insurer, licensed by the New York Department of Insurance and ultimately owned by petitioners Richard A. DiLoreto and Jeanne S. DiLoreto (the "DiLoretos"), both of whom are New York residents (PA:3).[1] Nassau conducted its business in New York, with Richard DiLoreto as its president (*id.*). In 1976, the DiLoretos established Ardra, as a Bermuda corporation, to reinsure risks originally underwritten by Nassau. Jeanne S. DiLoreto served as president of Ardra (*id.*). Nassau paid Ardra over $10 million in reinsurance premiums (PA:4).

On June 22, 1984, Nassau was placed in liquidation by order of New York State Supreme Court Justice Leonard N. Cohen (the "Liquidation Order") (RA:1). The Liquidation Order dissolved the insolvent Nassau, terminated all its subsisting contracts and other obligations (with "all liability thereunder [to] cease and be fixed" as of the date of the order), appointed the Superintendent of Insurance of the State of New York as Liquidator, vested the Liquidator with "title to all of the property, contracts and rights of action" of Nassau, and directed "that all persons indebted to NASSAU INSURANCE COMPANY render accounts of their indebtedness and pay any sums due to the Superintendent of Insurance as Liquidator" (RA:3-4, 7).

After the liquidation commenced, Ardra began to balk at paying losses under the reinsurance contracts, challenging the Liquidator's handling of claims on which Ardra had exposure. On February 13, 1985, approximately 20 actions involving claims against Nassau were scheduled for settlement conferences before Justice Stanley Parness in Supreme Court, New York County (CA:100). Richard DiLoreto, who by then had become president of Ardra, appeared on the reinsurer's behalf along with an attorney (*id.*). On the application of the Liquidator, Justice Parness excluded them from the conferences (*id.*).

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[1] References to PA:__ are to the Petitioners' Appendix; references to RA:__ are to the Respondent's Appendix; references to CA:__ are to the appendix in the New York Court of Appeals.

Within a week, Ardra disclaimed its liabilities under the reinsurance contracts on grounds that the Liquidator had breached the contracts' "association in the defense" clause (CA:100-102). Thereafter, the Liquidator commenced this action for the reinsurance proceeds due from Ardra (CA:218). The Liquidator also seeks recovery from the DiLoretos as *alter egos* of Ardra and for breach of their fiduciary duties to Nassau (CA:229-236).

In the proceedings below, the petitioners maintained that the arbitration clauses in the contracts between the two DiLoreto companies were enforceable against the respondent under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38, as implemented at 9 U.S.C. §§ 201-208 (the "Convention"). After removal from the State Court to the United States District Court for the Southern District of New York, that court abstained in deference to New York's comprehensive regulatory scheme for insurer insolvencies (PA:85-135) and a panel of the United States Court of Appeals for the Second Circuit unanimously affirmed (PA:57-84). The Liquidation Court ruled that the arbitration clauses were not enforceable against the respondent (PA:41-56), a unanimous panel of the Appellate Division, First Department affirmed (PA:22-35), and that decision was, in turn, affirmed by a unanimous New York Court of Appeals (PA:1-21).

The Court of Appeals found that the reinsurance agreements "fall within the general scope of the Convention" (PA:12), but that, because Article II of the Convention does not require arbitration where the controversy does not "concern a subject matter capable of settlement by arbitration" (Art. II.1) or where the arbitral agreement is "null and void, inoperative or incapable of being performed" (Art. II.3), the intervention of New York's statutory scheme for liquidating insolvent insurers precluded arbitration (PA:12-16). The decision of the Court of Appeals is reported at 77 N.Y.2d 225, 566 N.Y.S.2d 75 (1990).

REASONS FOR DENYING THE WRIT

The Court of Appeals' finding that Nassau's arbitral agreements do not bind its Liquidator constitutes independent

and adequate state grounds for decision (Point I). In any event, the Court properly applied the Convention's provision for non-enforcement of arbitral agreements that are "null and void, inoperative or incapable of being performed" (Point II). The Court's reference to the McCarran-Ferguson Act does not create a conflict with decisions of the Fourth and Ninth Circuits (Point III). Finally, compelling statutory liquidators to arbitrate with reinsurers would seriously impair state schemes for the orderly liquidation of insolvent insurers (Point IV).

I.

THE DETERMINATION THAT THE LIQUIDATOR IS NOT BOUND BY NASSAU'S ARBITRAL AGREEMENTS RESTS UPON INDEPENDENT AND ADEQUATE STATE LAW GROUNDS

State law determines who is bound by an arbitral agreement and, in this case, the New York Court of Appeals has authoritatively determined that the Liquidator does not succeed to Nassau's agreements to arbitrate with Ardra. Because the decision below rests on independent and adequate state law grounds, this Court lacks jurisdiction. *Herb v. Pitcairn*, 324 U.S. 117, 125-26 (1945); *Zacchini v. Scripps-Howard Broadcasting Co.*, 443 U.S. 562, 566 (1977); *Michigan v. Long*, 463 U.S. 1032 (1983). *Cf. Kirkpatrick v. Christian Homes of Abilene, Inc.*, 460 U.S. 1074 (1983).

The Court of Appeals concluded that, whatever their vitality during the companies' operating lives,[2] the arbitration clauses do not bind the Liquidator. Article II.3 of the Convention only requires reference to arbitration where the parties to an action "have made an agreement" to submit to arbitration (PA:140). Congress passed the Federal Arbitration Act "to enforce private

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[2] As a practical matter, the arbitration clauses relied upon by petitioners were an illusory feature of the subject reinsurance agreements. As the Court of Appeals recognized, "[t]he DiLoretos were the principals of Ardra and Nassau and both companies were wholly owned by them" (PA:19). So long as the two companies were going concerns, any dispute between them – even if one could conceivably arise – would be resolved by their common owners, not by arbitrators.

agreements *into which parties had entered.*" *Mitsubishi Motors Corporation v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985) (emphasis supplied). The Liquidator has entered into no such agreement. Nor is he, as a matter of New York law, so identified with the defunct insurer that he succeeds to its arbitral agreements.[3]

State law determines whether a contract containing an agreement to arbitrate is binding upon a particular party. In a case considered under the Convention, the Eighth Circuit recently looked to state law to determine whether a party was bound by an arbitral agreement: "[i]n addressing the issue of whether a party has entered into an agreement to arbitrate under the Arbitration Act, courts are to apply general state law principles, giving due regard to the federal policy favoring arbitration." *Recold, S.A. De C.V. v. Montfort of Colorado, Inc.*, 893 F.2d 195, 197 (8th Cir. 1990) (following *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989)). Aside from holding that courts should apply "general state-law principles of contract interpretation to an arbitration agreement within the scope of the [Federal Arbitration Act]," 489 U.S. at 1254, *Volt* states that "the FAA does not require parties to arbitrate when they have not agreed to do so" and that "[a]rbitration under the Act is a matter of consent, not coercion." *Id.* at 1255. *See also Valero Refining, Inc. v. M/T Lauberhorn*, 813 F.2d 60, 64 (5th Cir. 1987) ("[o]rdinary contract principles determine who is bound by a written arbitration agreement"); *A/S Custodia v. Lessin International Inc.*, 503 F.2d 318, 320 (2d Cir. 1974) (*per curiam*) (same).[4]

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[3] *Cf. Allegaert v. Perot*, 548 F.2d 432, 435-36 (2d Cir. 1977), declining to compel the trustee of a defunct securities firm to arbitrate a claim against the firm's controlling shareholder: "The trustee's position that he and the bankrupt are different legal entities is certainly correct. . . . [A] bankruptcy trustee is a new entity. . . with [his] own rights, subject to the supervision of the bankruptcy court."

[4] It bears emphasis that the Liquidator is not "assuming" an executory contract of the insolvent insurer and thus obligating himself upon it. *Cf.* Bankruptcy Code, 11 U.S.C. § 365. Aside from dissolving Nassau, the Liquidation Order terminated all of its subsisting contracts and other obligations, providing that "all liability thereunder cease and be fixed" as of the date of the order (RA:4). The Liquidator simply seeks to collect upon defendants' outstanding liabilities to Nassau as fixed in accordance with the Liquidation Order.

The Court of Appeals determined that, "Nassau no longer exists" and respondent "holds office as liquidator solely to protect the interests of policyholders, stockholders, and the public. . ." (PA:15).[5] To effectuate "New York's strong public policy concerns by maintaining the Supreme Court's exclusive jurisdiction over liquidation proceedings," the court ruled that Nassau's private commercial agreements to arbitrate would not be extended to bind its Liquidator and preclude litigation of matters affecting insureds and third-party claimants. (PA:17-18).

The New York Court of Appeals correctly relied upon state law in concluding that the extinguishment of Nassau's corporate existence, the cessation of its business, and the introduction of policyholder interests and the public interest generally, foreclose any duty to arbitrate (PA:14-16). The Liquidator has not, directly or by virtue of his successorship to Nassau's assets, "made an agreement to arbitrate" within Article II.3 and the Court of Appeals' determination is conclusive on that point.

II.

THE COURT OF APPEALS DID NOT ERR IN HOLDING THE ARBITRATION CLAUSES "NULL AND VOID, INOPERATIVE OR INCAPABLE OF BEING PERFORMED" UNDER ARTICLE II.3 OF THE CONVENTION

The Convention states specific exceptions to the enforceability of arbitral agreements. Apart from restricting recognition of arbitral agreements to controversies "concerning a subject matter capable of settlement by arbitration" (Art. II.1), the

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[5] Of these constituencies, the Nassau stockholders' interests are most attenuated by the insolvency, while the policyholder and public interests have, by the same exigency, come to the fore. Yet the petitioners would exalt a phantom commitment of the stockholders – from one of their companies to another of their companies – over the paramount concerns of policyholders and of the public, who never agreed, directly or vicariously, to arbitrate.

Convention authorizes non-enforcement where the arbitral agreement is "null and void, inoperative or incapable of being performed" (Art. II.3).

Quoting from *Mitsubishi*, 473 U.S. at 639 n.21, petitioners contend that only Congress can except a particular subject matter from arbitration under the Convention (Petition at 33). Although the Court of Appeals used the term "subject matter" in finding this dispute non-arbitrable, the term was not used in the same sense as it is employed in the Convention (Art. II.1) or in this Court's decision in *Mitsubishi*. The court did not find that liability under reinsurance agreements is non-arbitrable subject matter. It found that the intervention of New York's liquidation process, and the duties and limitations that that process imposes upon the Liquidator, bar enforcement of the arbitration clauses against the Liquidator (PA:16) ("[t]he Legislature has not granted the Superintendent the authority to arbitrate disputes and under the [liquidation] statute's provisions, the subject matter of the claims against Ardra must be litigated in [the Liquidation] Court"). The court's decision is not an "impermissable nullification of [Art. II.1 of] the Convention" as construed by *Mitsubishi* (Petition at 34); it is a straightforward application of the Article II.3 exceptions.

Relying upon its prior holding in *Knickerbocker Agency, Inc. [Holz]*, 4 N.Y.2d 245, 173 N.Y.S.2d 602, 149 N.E.2d 885 (1958), the court properly held that the intervention of New York's statutory liquidation scheme and the appointment of the Liquidator triggered the Article II.3 exceptions. Petitioners ardently contend that these exceptions to enforceability apply only to "internationally recognized defenses such as duress, mistake, fraud, or waiver" (Petition at 34) (*quoting Rhone Mediterranee Compagnia Francese v. Lauro*, 712 F.2d 50, 53 (3d Cir. 1983); *Ledee v. Ceramiche Ragno*, 684 F.2d 184, 187 (1st Cir. 1982); *I.T.A.D. Assocs. v. Podar Bros.*, 636 F.2d 75, 77 (4th Cir. 1981); *Oriental Commercial & Shipping Co. v. Rosseel, N.V.*, 609 F. Supp. 75, 78 (S.D.N.Y. 1985)). However, they offer no basis for concluding that the insolvency of a contracting party and the appointment of a Liquidator does not impair an arbitral

agreement every bit as much as the circumstances included in that illustrative list.

The advent of insolvency always introduces new interests to the formerly private commercial arrangements of the debtor and commonly requires the centralization of claims by and against the debtor in the insolvency court. This is an internationally recognized fact of business life. For example, a federal Bankruptcy Court may decline to compel a bankruptcy trustee to arbitrate claims arising under the debtor's contracts, at least where the trustee has not "assumed" those contracts pursuant to the Bankruptcy Code, 11 U.S.C. § 365.[6]

Enforcement of a bankrupt's arbitral agreement will be denied where arbitration "would seriously jeopardize the objectives of the [Bankruptcy] Code." *Hays & Co. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1161 (3rd Cir. 1989). The court or court system responsible for administering the insolvency is best situated to make the judgment that arbitration would so jeopardize the insolvency scheme in a given case. Because insurer insolvencies are excluded from the federal bankruptcy system, 11 U.S.C. § 109[b][2], and administered by a state liquidation court, that court, under the supervision of the state appellate courts, is appropriately vested with responsibility to measure possible jeopardy to the state scheme. Here, where Ardra sets up the Liquidator's own conduct in excluding the reinsurer's representatives from settlement conferences as the basis for withholding reinsurance proceeds and collaterally attacks a judicial determination upholding that exclusion, the state courts' judgment that arbitration would impair New York's liquidation scheme is entitled to stand. The intervening insolvency has made Nassau's arbitral agreements "null and void, inoperative or incapable of being performed."

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[6] Bermuda law is very similar. Where the trustee in bankruptcy does not "adopt" a contract including an arbitration clause, the enforceability of that clause is committed to the Bankruptcy Court's discretion, which is to be exercised "having regard to all the circumstances of the case. . . ." Bermuda Arbitration Act of 1986, § 6.

Granting the primacy of state law is most necessary where a party's capability of performing the arbitral agreement is in question and that party is fulfilling a role ordained by state statute and functioning under the supervision of a state court.[7] New York's highest court has held that "absent express authority to do so, the Superintendent [cannot] engage in arbitration when acting as a liquidator" and that "the legislature has not granted the Superintendent the authority to arbitrate disputes" (PA:16). Compelling arbitration in such circumstances would consign the Liquidator to a legal no man's land — statutorily and judicially precluded from arbitrating and federally barred from a judicial forum.

III.

THE COURT OF APPEALS DID NOT ERR IN CLASSIFYING THIS ASPECT OF NASSAU'S LIQUIDATION AS THE "BUSINESS OF INSURANCE" WITHIN McCARRAN-FERGUSON — IF THAT IS WHAT IT DID

Petitioners address their primary challenge to what the Court of Appeals "necessarily held" concerning the "business of insurance," i.e., that the liquidation of an insolvent insurer, taken as a whole, is the business of insurance within McCarran-Ferguson. However, the court's opinion does not even discuss the point. To contrive a cert-worthy question, the petitioners would wrest from the opinion below the implicit holding that the liquidation of an insolvent insurer *is* the business of insurance (when, at best, the court implied that a liquidator's collection of reinsurance proceeds is the business of insurance). Then, the petitioners would set that putative holding in opposition to two federal circuit decisions which are represented to hold that the liquidation of insolvent insurers is *not* the business of

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[7] These circumstances also distinguish the case from *Mitsubishi* where the Court upheld enforcement of an arbitral agreement against a private antitrust plaintiff: "the antitrust cause of action remains at all times under the control of the individual litigant; no citizen is under an obligation to bring an antitrust suit and the private antitrust plaintiff needs no executive or judicial approval before settling one." 473 U.S. at 636 (citations omitted).

insurance (when, in fact, those cases hold only that one feature of the subject state liquidation statutes – the priority scheme for distribution of the insolvent's assets – falls outside of McCarran-Ferguson). *Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989); *Gordon v. United States Dept. of Treasury*, 846 F.2d 272 (4th Cir.) (*per curiam*), *cert. denied*, 488 U.S. 954 (1988). Only by overstating the respective holdings of these cases, do the petitioners discover the "direct conflict" they would have this Court resolve.

What the Court Said

Far from authoring a sweeping expansion of McCarran-Ferguson to insulate the entire state liquidation scheme from federal preemption, much less "entirely exempt[ing] anything insurance companies do" (Petition at 24), the Court of Appeals mistakenly *diminished* the statute's role in the case. Concerning preemption, the court wrote:

> If the Convention requires arbitration, it preempts provisions of the McCarran-Ferguson Act, the Federal Arbitration Act, and the State Insurance Law empowering the Superintendent to litigate on behalf of an insolvent insurance company. The focus, therefore, must be on the Convention, not the federal statutes.

(PA:8) (citations omitted). This passage suggests that McCarran-Ferguson did not influence the analysis below.[8]

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[8] The proposition that a treaty "preempts" federal statutes tends to show that McCarran-Ferguson received only passing consideration. There is no prescribed pecking order, constitutional or otherwise, that elevates treaties over statutes. A treaty is "to be regarded in the courts of justice as equivalent to an act of the legislature." *Foster v. Neilson*, 27 U.S (2 Pet.) 253, 314 (1829) (Chief Justice Marshall). "By the Constitution, laws made in pursuance thereof and treaties made under the authority of the United States are both declared to be the supreme law of the land, and no paramount authority is given to one over the other. . . ." *Chae Chan Pong v. United States*, 130 U.S. 581, 600 (1889).

However, the Court of Appeals' error in this regard only aided the petitioners because it erased McCarran-Ferguson as a limitation on the Convention and its implementing legislation. Given its proper weighting, McCarran-Ferguson insulates from preemption New York's regulatory scheme, insofar as it bars the Liquidator from arbitrating a claim for reinsurance proceeds.

The court's second reference to McCarran-Ferguson, a bare citation, is the only hook for petitioners' claim that the court "necessarily held" that the liquidation of insolvent insurers is state regulation of the business of insurance. In construing the Convention, and after acknowledging *Mitsubishi*'s admonition that the Convention's exceptions be "implemented by examining the domestic law of an acceding nation" (PA:13), the court went on to say:

> In the United States statutes provide that insurance is generally a matter of State concern and that the laws of the individual states govern (McCarran-Ferguson, 15 U.S.C. §§ 1011-1012[b], *supra*; *see also*, The Bankruptcy Act, 11 U.S.C. § 109[b][2](which exempts insurance companies from its provisions). Thus, in this case, the law to be applied in interpreting the exceptions is Article 74 of the New York Insurance Law.

(PA:14). The citation to McCarran-Ferguson suggests it was a steppingstone by which the court reached state law to interpret the Convention's exceptions – although subsequent expressions of the court's holding omit any reference to the statute.[9] In any event, the opinion features no discussion of the "business of insurance."

The "Business of Insurance"

Apart from lacking a firm foundation in the opinion below, the Petition misconceives the McCarran-Ferguson statute when it proposes the question whether "the liquidation of an insolvent insurance company falls within McCarran-Ferguson's exemption from federal law" (Petition at i). One might just as usefully ask whether the operation of a solvent insurance company falls within the McCarran-Ferguson exemption. In each

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[9] *E.g.*, "We conclude, therefore, that although the referenced agreements fall within the broad terms of the Convention, plaintiff is excepted from arbitration because the arbitration clause and the dispute alleged to be subject to it are not capable of performance and settlement under the law of New York" (PA:20-21).

case, the answer depends upon the specific activity under examination, its proximity to the core of the "business of insurance," and its place within the state regulatory scheme.

Just as some activities of operating insurance companies will not constitute the business of insurance within McCarran-Ferguson,[10] some activities of defunct insurers *will* constitute the business of insurance. The petitioners' approach — broadly excluding post liquidation activities from the business of insurance — would eviscerate McCarran-Ferguson's protection of the state regulatory scheme at a time when the need for its coherent operation is most acute.

That approach cannot be reconciled with this Court's decisions elucidating the "business of insurance," nor is it a logical outgrowth of the Fourth and Ninth Circuit decisions cited by petitioners. This Court's opinion in *S.E.C. v. National Securities, Inc.*, 393 U.S. 453, 460 (1969), generally defined the business of insurance to include:

> The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement — these were the core of the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class.

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[10] "Insurance companies may do many things which are subject to paramount federal regulation; only when they are engaged in the 'business of insurance' does [McCarran-Ferguson] apply." *S.E.C. v. National Securities, Inc.*, 393 U.S. 453, 459-60 (1969). *Compare Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 744 (1985) (state laws regulating the terms of insurance *contracts*, such as law requiring provision for mental health coverage, are laws regulating the business of insurance) *with Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 131 (1981) (insurer's use of chiropractic "peer review committees" to audit submitted claims not business of insurance, though such committees may assist insurer in conducting its operation); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 214 (1978) (purchase agreements between insurer and pharmacists not business of insurance, though such agreements undoubtedly provide economic advantage to insurer).

The Liquidator's collection of reinsurance proceeds is central to the reliability of Nassau policies. During this case's excursion through the federal courts, the Second Circuit Court of Appeals observed:

> Under New York law, the Superintendent's power to collect on reinsurance agreements entered into by a liquidated company is a matter of no little concern, for policy holders have no direct right of action against reinsurers; only the Superintendent, as liquidator, can recover from the reinsurer. The extent to which the Superintendent is able to collect thus affects the degree to which the insolvent insurer's estate will have assets sufficient to satisfy the claims of its creditors.

(PA:82-83) (citations omitted).[11] For that reason, the Liquidator's collection of reinsurance proceeds is systematically facilitated by New York's regulatory scheme. The Insurance Law vests him with "title to all property, contracts and rights of action of [the] insurer as of the date of entry of the order" and provides that a liquidation order shall direct the liquidator "forthwith to take possession of the property of [the] insurer." N.Y. Ins. Law § 7405. The statute also assures that reinsurance proceeds will be payable "without diminution because of the insolvency of the ceding insurer" by requiring inclusion of a clause to that effect in the reinsurance agreement as a condition to the insurer taking credit for reinsurance on its statutory statement. N.Y. Ins. Law § 1308.[12]

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[11] Although guaranty funds often step in to fund payment of claims to policyholders, they are jurisdictionally limited with respect to the types of policyholders and claims covered and with respect to the amount of coverage. Moreover, as the United States District Court noted, the guaranty fund's own reliability is, in part, a function of its ability to recoup from the liquidation estate amounts paid to policyholders (PA:118).

[12] Absent an "insolvency clause," the Liquidator could not collect the reinsured portion of a loss without having first paid it out — a step that may be foreclosed by the insolvency. *Fidelity & Deposit Co. of Md. v. Pink*, 302 U.S. 224, 228 (1937), *reh'g denied*, 302 U.S. 780 (1938). Each of the subject reinsurance agreements has such a clause (CA:74, 83, 93).

The reinsurance arrangements of a liquidating company, and the Liquidator's collection of proceeds due under those arrangements, readily satisfy the three "business of insurance" criteria identified by this Court in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982).[13] A reinsurance arrangement spreads the primary insurer's risk on a given policy or class of policies. Reinsurance is the "ceding by one insurance company to another of all or a portion of its risks for a stipulated portion of the premium. . . ." 13A Appleman, *Insurance Law and Practice*, § 7681 (rev. ed. 1976). Reinsurance is an "integral part of the relationship between the policyholder and the insurer" because it supports the insurer's obligations to the policyholder. *Corcoran v. Universal Reinsurance Corp.*, 713 F. Supp. 77, 82-83 (S.D.N.Y. 1989) ("[w]here an insurance carrier has financed its exposure through reinsurance, its policies are worth no more than the reinsurance behind them"). For that reason, "[r]einsurance takes on added significance when the insurer becomes insolvent." *Skandia America Reinsurance Corp. v. Schenck*, 441 F. Supp. 715, 724 (S.D.N.Y. 1977). Finally, the relationship between the insurer and reinsurer is self-evidently "limited to entities within the insurance industry," not just as a matter of practice but as a regulatory imperative. N.Y. Ins. Law § 1308(a)(1) and § 107(a)(8).

State and federal courts have recognized that reinsurance is part of the business of insurance. *In re Insurance Antitrust Litigation*, 723 F. Supp. 464, 473 (N.D. Cal. 1989) ("[t]here is no authority for excluding reinsurance from the business of insurance") (applying *Pireno*); *American Mutual Reinsurance Co. v. Calvert Fire Insurance Co.*, 52 Ill. App. 3d 922, 927, 367 N.E.2d 104, 109 (Ill App. Ct. 1977), *cert. denied*, 436 U.S. 906 (1978) ("the ultimate purpose of [a reinsurance agreement] is to provide reliable insurance to policyholders") (following *National Securities*). *See also Feinstein v. Nettleship Co. of Los*

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[13] Those criteria are "first, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry." 458 U.S. at 129.

Angeles, 714 F.2d 928 (9th Cir.), *cert. denied*, 466 U.S. 972 (1984) (holding that McCarran-Ferguson precludes application of federal antitrust legislation to a group of California medical insurers that included reinsurers).

The two federal circuit court decisions cited by petitioners in support of a categorical exclusion of liquidating companies from McCarran-Ferguson cannot sustain that characterization. Regardless of whether they were correctly decided, they were plainly limited to a single, and markedly different, aspect of the respective insurer liquidation statutes – the prescription of a priority scheme for distribution of the defunct insurer's assets.

In *Gordon*, the Fourth Circuit adopted, in all but one respect, the district court's holding that Maryland's statutory priority scheme was not a regulation of the "business of insurance."[14] As formulated by the lower court in that case, the "sole question is whether the State of Maryland was acting to regulate the 'business of insurance' when it established the statutory scheme regarding the liquidation of insolvent insurance companies *and the priorities of claimants or policyholders for payment*." 668 F. Supp. at 486 (emphasis supplied). The court answered only that narrow question and, regardless of whether it answered correctly, it did not decide whether the liquidation of the insolvent insurer *per se* is the business of insurance.[15]

In *Soward*, the Ninth Circuit addressed the same question and was equally at pains to curtail its holding to the single feature of Idaho's liquidation scheme that was assertedly preempted:

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[14] The Fourth Circuit declined to adopt the district court's suggestion that the first element of the *Pireno* test – that the practice has the effect of transferring or spreading a policyholder's risk – stated an "indispensable" requirement. 846 F.2d at 273.

[15] "The question of whether other portions of the Maryland Insurance Code regulate the 'business of insurance' is not before the Court and is not relevant to the Court's opinion and rulings in this case." 668 F. Supp. at 486-7, n.4.

> Idaho believes that we should not look only at § 41-3342 [setting the priority of distribution] to decide the case but should examine the entire statutory scheme erected by Idaho Insurance Code. There are several problems with this suggestion, the most obvious of which is that it begs the question. When considered as a whole, obviously the statute does seek to regulate the business of insurance; *but the question is whether the specific provision constitutes the type of regulation that Congress sought to protect from indirect federal preemption by passing the McCarran-Ferguson Act.*

858 F.2d at 454-55 (emphasis supplied). *Soward*'s holding is an answer to that specific question, not a categorical debarment of state liquidation schemes from McCarran-Ferguson's protected realm.

For the foregoing reasons, petitioners have failed to show that the Court of Appeals' decision in this case presents any actual conflict with the decisions of the Fourth and Ninth Circuits in *Gordon* and *Soward*, respectively.[16]

IV.

COMPELLING ARBITRATION WITH FOREIGN REINSURERS WOULD JEOPARDIZE THE ORDERLY LIQUIDATION OF INSOLVENT INSURERS

Enforcing arbitration clauses against the Liquidator of an insolvent insurer would seriously undermine the statutory scheme. In this regard, the industry customs and the statistics featured in the petition prove too much. To say that there has been a proliferation of insurer insolvencies within the United

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[16] Petitioners' additional argument that McCarran-Ferguson applies only to interstate commerce and not to foreign commerce (Petition at 36-39) is supported by no case authority whatsoever and is soundly defeated by the plain language of the statute, which provides that "No Act of Congress" shall preempt state regulation to the business of insurance "unless such Act specifically relates to the business of insurance..." There is no interstate commerce limitation.

States (Petition at 54-56); that a considerable proportion of the reinsurance protecting domestic insurers has been placed with foreign reinsurers (*id.* at 56-57); and that reinsurance contracts almost invariably provide for arbitration of disputes between the ceding company and the reinsurer (*id.* at 59) only demonstrates that reversal would widely affect, and materially impair, state insurer liquidation procedures.

Compelling the Liquidator to arbitrate would eradicate important substantive and procedural protections. Without ever having agreed to relinquish them, the Liquidator (and the policyholder and public interests he represents) would forfeit a judicial forum, any right of substantive appeal, and would even have to forego the scrupulous application of the pertinent law to the dispute.[17] Moreover, the New York Insurance Law, § 1213(c) provides that, before filing an answer, an unauthorized alien insurer (such as Ardra) must post security with the clerk of court in an amount sufficient to secure any judgment which may be rendered against it.[18] Section 1213(c) protects claimants against unauthorized alien insurers from litigating all the way to judgment only to find that they must go to a foreign country to obtain enforcement.[19] In arbitration under the Convention, the Liquidator would be constrained to proceed without pre-answer security. *Cf. Cooper v. Ateliers de la Motobecane*, 57 N.Y.2d 408, 456 N.Y.S.2d 728 (1982) (provisional remedy of prejudgment attachment unavailable in case falling under the Convention).

Moreover, to compel the Liquidator to arbitrate each and every reinsurance dispute and, indeed, often to compel him to arbitrate in foreign countries,[20] would grotesquely multiply the expense

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[17] The arbitration clauses provide that the arbitrators are "relieved of all judicial formalities and may abstain from following the strict rule of law" (CA:74, 82, 92).

[18] The only alternative permitted by the statute is for the alien insurer to obtain a license to conduct an insurance business in New York. N.Y. Ins. Law § 1213(c)(1)(B).

[19] This important statutory protection is not unique to New York; it is New York's enactment of the Uniform Unauthorized Insurers Service of Process Act.

[20] One of the subject reinsurance contracts provides for arbitration in Hamilton, Bermuda (CA:92).

and delay associated with marshalling the reinsurance proceeds due to the insolvency estate. Not only would the Liquidator be forced to engage counsel and maintain suit in foreign countries, he would also be constrained to pay his share of the arbitrators' fees. All of this would tax the resources of an entity that is already insolvent.

Nothing about this case requires that it become the vehicle to achieve such a result. Although petitioners make much of it, the "international" character of the arbitral agreements between the DiLoreto companies may prove to be as illusory as the agreements themselves. The Liquidator alleges that Ardra, ostensibly a Bermuda corporation, is merely an *alter ego* of the DiLoretos, who are New York residents (CA:229-236). Due to the interlocutory posture of the case, the *alter ego* claim has not yet been determined; but, after noting the companies' common ownership, the Court of Appeals did observe that "Nassau and the DiLoretos were New York residents and were amenable to process in New York," that the contracts "specifically referred to New York law in various clauses," and that the case "does not present an international merchant subjected to unfamiliar judicial proceedings and the vagaries of foreign law" (PA:19-20). If Ardra is ultimately held to be just an *alter ego* of the DiLoretos, then the case will shed any pretense of being an international controversy within the Convention's purview.

CONCLUSION

For the foregoing reasons, the petition should be denied.

Respectfully submitted,

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Counsel of Record

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Counsel for Respondent

May 10, 1991

APPENDIX

At a Special Term, Part I of the Supreme Court of the State of New York, held in and for the County of New York, at the Court house, 60 Centre Street in the Borough of Manhattan, City and State of New York, on the 22nd day of June, 1984.

PRESENT:

HON. LEONARD N. COHEN

JUSTICE.

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Index No. 42173/1984

In the Matter of

ORDER OF LIQUIDATION

the Application of

JAMES P. CORCORAN, as Superindentent of Insurance of the State of New York, for an order to take possession of and liquidate the business of and dissolve

NASSAU INSURANCE COMPANY

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Petitioner, JAMES P. CORCORAN, Superintendent of Insurance of the State of New York, having moved this Court for an order to take possession of the property and to liquidate the business and affairs and to dissolve the corporate existence of NASSAU INSURANCE COMPANY, and such motion having duly come on before this Court on the 22nd day of June, 1984.

NOW, upon reading and filing the order to show cause made on the 18th day of June, 1984 by the Hon. Justice THOMAS J. HUGHES, one of the Justices of the Supreme Court of the State of New York, and the petition of JAMES P. CORCORAN, Superintendent of Insurance of the State of New York, verified

the 15th day of June, 1984, and the exhibits annexed thereto, with proof of due service thereof, in support of said motion, and it appearing to my satisfaction that NASSAU INSURANCE COMPANY was incorporated under the laws of the State of New York on December 2, 1964 and licensed as a stock casualty insurer in the State of New York on May 5, 1965; that its principal office is located in the County of Nassau, City and State of New York; that it is amenable to the Insurance Law of the State of New York and particularly to Article XVI thereof, and upon reading the order of rehabilitation entered in the New York County Clerk's office on the 13th day of March, 1984; Exhibit "A" annexed to the petition herein, and it appearing to my satisfaction that further efforts to rehabilitate NASSAU INSURANCE COMPANY would be futile and that the rehabilitation proceeding of the said corporation should be terminated; that it is impossible to reinsure in whole or in part the existing policy obligations of NASSAU INSURANCE COMPANY pursuant to the provisions of Section 514 (2a), Insurance Law, and that the Liquidator should be relieved of the requirement of said Section; that NASSAU INSURANCE COMPANY is insolvent; that it is in such condition that its further transaction of business would be hazardous to its policyholders, creditors or to the public; that it is to the best interests of all persons concerned that this application should be granted and NASSAU INSURANCE COMPANY should be liquidated under and pursuant to Article XVI of the Insurance Law; that it should be dissolved and its corporate charter annulled and forfeited; and petitioner having appeared by Hon. ROBERT ABRAMS, Attorney General of the State of New York, in support of said motion, and there being no appearance in opposition thereto, and after due deliberation having been had thereon and upon filing the opinion of the Court;

NOW, on motion of Hon. ROBERT ABRAMS, Attorney General of the State of New York, it is

ORDERED, that the petition of JAMES P. CORCORAN, Superintendent of Insurance of the State of New York, be and the same hereby is in all respects granted; and it is further

ORDERED, that NASSAU INSURANCE COMPANY be and it hereby is adjudged to be insolvent; and it is further

ORDERED, that the rehabilitation proceeding of the NASSAU INSURANCE COMPANY is hereby simultaneously terminated with the entry of the order herein; and it is further

ORDERED, that JAMES P. CORCORAN, Superintendent of Insurance of the State of New York, and his successors in office as Superintendents of Insurance of the State of New York, be and he is and they are hereby appointed Liquidator of NASSAU INSURANCE COMPANY, and are hereby authorized and directed forthwith to take possession of the property and liquidate the business of NASSAU INSURANCE COMPANY under and pursuant to the provisions of Article XVI of the Insurance Law of the State of New York and to deal with the property and business of NASSAU INSURANCE COMPANY in his or their names as Superintendents of Insurance and he is and they are vested with title to all of the property, contracts and rights of action of NASSAU INSURANCE COMPANY, pursuant to Section 514 of the New York Insurance Law; and it is further

ORDERED, that the notice of the aforesaid be given by publication in the editions of the New York Times and The Journal of Commerce, commencing on or about 11th day of July, 1984, and thereafter once a week for two successive weeks; and it is further

ORDERED, that the notice hereinbefore prescribed is sufficient notice to all persons interested in the assets of NASSAU INSURANCE COMPANY; and it is further

ORDERED, that formal notice of the making and entry of this order be given by the Superintendent of Insurance, as Liquidator, by mail to all policyholders, creditors and all other persons having any unsatisfied claim or demand of any character against the corporation as disclosed by the books and records of the corporation in the possession of the Superintendent of Insurance, as Liquidator, at the last known address of such persons as disclosed by said records and in such other manner and

form as he in his discretion may find desirable, demanding that all persons indebted to NASSAU INSURANCE COMPANY render accounts of their indebtedness and pay any sums due to the Superintendent of Insurance, as Liquidator; and giving notice to present proofs of claim with the Superintendent of Insurance, as Liquidator, at a place specified in such notice within twelve months from the date of the entry of this order and no later than the 30th day of June, 1985; and that such notice may contain such other rules, regulations and information as the Superintendent of Insurance, as Liquidator, may deem necessary for the purpose of this proceeding in fixing and determining all lawful and valid claims and demands against the corporation; and it is further

ORDERED, that in the event one or more Insurance Departments and/or Guaranty Funds or Associations of foreign states that have adopted the Uniform Insurers Liquidation Act in which respondent was licensed to do business, desire to give formal notice to policyholders and creditors in their respective states to present proofs of claim to the respective State Insurance Department or Guaranty Fund or Association, the Superintendent of Insurance, as Liquidator, may permit the giving of such notice as he in his discretion may find desirable; and it is further

ORDERED, that all outstanding policy and other insurance obligations of NASSAU INSURANCE COMPANY terminate and all liability thereunder cease and be fixed as of 12:01 A.M., Eastern Daylight Savings Time, on the 10th day of August, 1984, or prior thereto upon the procurement by policyholders, respectively, of new insurance covering their risks insured thereby, and notice thereof shall be given as hereinabove set forth; and it is further

ORDERED, that all other subsisting contracts, tax sharing agreements and other obligations of NASSAU INSURANCE COMPANY terminate, and all liability thereunder cease and be fixed as of the date of the entry of this order; and it is further

ORDERED, that the Superintendent of Insurance, as Liquidator, be and he hereby is relieved of the provisions set forth

in Section 514 (2a), Insurance Law, to wit: to reinsure in whole or in part the policy obligations of NASSAU INSURANCE COMPANY; and it is further

ORDERED, that JAMES P. CORCORAN, Superintendent of Insurance of the State of New York, and his successors in office as Superintendents of Insurance of the State of New York, be and he is and they are hereby authorized, permitted and allowed to sell, assign and transfer any and all of the stocks, bonds and securities in his possession or which may hereafter come into his possession belonging to NASSAU INSURANCE COMPANY, in liquidation, at market price or better, or when there is no market price, at the best price obtainable, at private sale and at such times and upon such terms and conditions as in his discretion he deems for the best interests of the creditors of NASSAU INSURANCE COMPANY, in liquidation, and that he be authorized, permitted and allowed to take such steps and to make and execute such agreements and other papers as may be necessary to effect and carry out such sales, transfers and assignments; and it is further

ORDERED, that said NASSAU INSURANCE COMPANY, its officers, directors, trustees, policyholders, agents and employees and all other persons having any property or records belonging to the said NASSAU INSURANCE COMPANY, are hereby directed to assign, transfer and deliver to the Superintendent of Insurance, as Liquidator, all of such property in whomsoever name the same may be, and that any persons, firms or corporations having any books, papers or records relating to the business of said corporation shall preserve the same and submit them to the Superintendent of Insurance, as Liquidator, for examination at all reasonable times; and it is further

ORDERED, that the officers, directors, trustees, policyolders, agents and employees of said NASSAU INSURANCE COMPANY, and all other persons be and they hereby are enjoined and restrained from the further transaction of business or from dealing with or disposing of the property or assets of said corporation, or doing or permitting to be done any act or thing which might waste its property or assets or allow or suffer the

obtaining of preferences, judgments, attachments or other liens, or the making of any levy against said corporations, or its estate while in the possession and control of the Superintendent of Insurance, as Liquidator; and it is further

ORDERED, that the officers, directors, trustees, policyholders, agents and employees of said NASSAU INSURANCE COMPANY, and all other persons, including but not limited to claimants, plaintiffs and petitioners who have claims against the said NASSAU INSURANCE COMPANY, be and they hereby are permanently enjoined and restrained from bringing or further prosecuting any action at law, suit in equity, special or other proceeding against the said corporation or its estate, or the Superintendent of Insurance of the State of New York and his successors in office as Liquidator thereof, or from making or executing any levy upon the property or estate of said corporation, or from in any way interfering with the Superintendent of Insurance of the State of New York, or his successors in office, in his or their possession, control or management of the property of said corporation, or in the discharge of his or their duties as Liquidator thereof, or in the liquidation of the business of said corporation; and it is further

ORDERED, that all parties to law suits in this state and all other states and territories of the United States, are hereby enjoined and restrained from proceeding with any pre-trial conference, trial, application for judgment, or proceeding on judgments or settlements in such actions at law, suits in equity, special or other proceedings in which NASSAU INSURANCE COMPANY is obligated to defend a party insured or any other person it is legally obligated to defend by virtue of its insurance contract for a period of 180 days from the date hereof; and it is further

ORDERED, that those persons who may have first party or New York Comprehensive Automobile Insurance Reparations Act (No Fault) policyholder loss claims against NASSAU INSURANCE COMPANY coming within the purview of Sections 330, 333 and 334 of the New York Insurance Law, are enjoined for 90 days from the date hereof from presenting and filing such

formal claims in this proceeding, pursuant to Section 543 of the New York Insurance Law; and it is further

ORDERED, that the corporate charter of said NASSAU INSURANCE COMPANY be and the same hereby is forfeited, surrendered and annulled and the said NASSAU INSURANCE COMPANY is hereby dissolved; and it is further

ORDERED, that all further papers in this proceeding shall bear the caption and be entitled;

"SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of

the Liquidation of

NASSAU INSURANCE COMPANY"

in place and stead of the caption as heretofore used; and it is further

ORDERED, that Superintendent of Insurance, as Liquidator, may at any time make further applications at the foot of this order for such further and different relief as he sees fit.

E N T E R

/s/ Leonard N. Cohen

J.S.C.